

Before the  
COPYRIGHT ROYALTY BOARD  
LIBRARY OF CONGRESS  
WASHINGTON, D.C.

In the Matter of	)	Docket No. 2005-1 CRB DTRA
	)	
DIGITAL PERFORMANCE RIGHT IN	)	
SOUND RECORDINGS AND EPHEMERAL	)	
RECORDINGS	)	
	)	

**REPLY FINDINGS OF FACT  
AND CONCLUSIONS OF LAW**

**PUBLIC VERSION**

David D. Oxenford  
*Counsel for AccuRadio, LLC; Digitally  
Imported, Inc.; Radioio; Discombobulated,  
LLC; 3wk, LLC and Radio Paradise, Inc.*

Davis Wright Tremaine LLP  
1500 K Street, N.W., Suite 450  
Washington, D.C. 20005  
(202) 508-6600

Dated: December 15, 2006

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**Reply Findings of Fact and Conclusions of Law**

The Small Commercial Webcasters (individually, an "SCW")<sup>1</sup>, by their attorneys and pursuant to the Order of the Copyright Royalty Board dated November 28, 2006 and 37 CFR § 351.14, hereby submit their Reply Findings of Fact and Conclusions of Law in the above-referenced matter in response to the Findings of Fact and Conclusions of Law of SoundExchange, Inc. Contrary to the handful of SoundExchange's findings and conclusions that were nominally addressed to the SCWs, the SCWs should be treated a separate class from the large webcasters, and the Board should adopt a separate royalty rate for the SCWs.<sup>2</sup>

SoundExchange Findings and Conclusions do not challenge the SCW's testimony that the global royalty rate proposed by SoundExchange would drive existing SCWs out of business, and would create an absolute barrier to entry for all small, independent webcasters attempting to enter the market (that is, all entrants not supported by significant financial resources from other

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<sup>1</sup> The Small Commercial Webcasters are AccuRadio, Inc.; ioRadio; Digitally Imported Radio; Discombobulated, LLC; 3wk, LLC and Radio Paradise.

<sup>2</sup> To the extent that the Board establishes a royalty rate for all webcasters that approximates the separate rate proposed by the SCWs, the SCWs' request for a separate rate would obviously be moot. However, if a higher rate is set, or a rate with usage minimums is established, the separate rate urged herein is imperative for the survival of the SCW.

businesses that would allow the entity to survive an extended period of royalties exceeding revenues). SoundExchange has submitted no evidence relating specifically to the SCWs that suggests that the Board should not adopt the separate royalty rate proposed by the SCWs based on a percentage of revenue model.

Instead, SoundExchange merely argues that the demise of smaller webcasters should be of no concern to the Board or to the Librarian of Congress. As set forth in the SCW Findings and Conclusions, and further detailed herein, Congress never imagined a royalty rate which would only allow webcasters which have “spillover” from other businesses to continue to operate. Instead, as set out in Section 114(f)(2)(B), and as further evidenced by the adoption of the Small Webcaster Settlement Act, Congress envisioned various classes of webcasters operating on the Internet. These classes must include the Small Commercial Webcasters, one of the very classes that Congress intended to preserve by its adoption of the Small Webcaster Settlement Act.

Despite its arguments that small webcasters should not be accorded separate treatment, and that it is of no concern if all such entities are “winnowed” from the market, SoundExchange continues to rely heavily on revenue projections and other data from existing SCWs in support of its theory that webcasting is now – and will be in the future – profitable for all entrants. This reliance is misplaced. First, as a factual matter, most existing SCWs simply are not profitable at the present time. Second, the Small Commercial Webcaster Settlement Act mandated a separate, percentage-of-revenue rate for the SCWs, such that any financial conclusions that may be drawn, or projections that may be made, about the potential success of SCWs based on their current performance, would be moot if the current structure is eliminated. As the SCWs have shown, and SoundExchange has not refuted, the SCWs would have royalties in excess of revenues if

they were forced to pay under either the current general royalty scheme or under that proposed by SoundExchange. Third, the economics for small webcasters and large webcasters are simply different. While both must ultimately attract an audience sufficient to provide revenues that exceed expenses, the survival of small webcasters depends on revenues keeping pace with expenses on a monthly basis, whereas a large webcaster may have the financial resources from other business lines to survive for a long period of time during which expenses exceed revenues. Indeed, for large portals, webcasting conceivably might never turn a profit, so long as that business supports other facets of the portal's business in a manner that ensures overall financial success.

Given SoundExchange's failure to adequately support its contention that the SCWs should not be considered separately from other webcasters, SCW's proposed statutory royalty rate for a class of small commercial webcaster reflecting 5% of their gross revenue is the appropriate benchmark and should be adopted by the Board.

### **Reply Findings of Fact**

1. In its Findings of Fact ("SX FoF"), SoundExchange largely ignores the testimony of the SCWs, except in a misplaced attempt to further its own "economic surplus" analysis and its argument that the webcasting market has improved since the 2002 CARP. Instead, when it refers to the SCWs at all, SoundExchange attempts to portray this class of small and financially independent webcasters either as similar to noncommercial webcasters, or as similar to the large commercial webcasters, depending on which approach suits SoundExchange for the particular point it is making.

2. Indeed, SoundExchange's only direct references to the SCWs as a class are as follows:

(a) “It does not make sense to set a market rate based on smaller webcasters, noncommercial webcasters, or other webcasters not attempting to maximize their webcasting revenues, because those buyers are not primarily driven by market concerns.” (SX FoF, ¶ 211)

(b) “The CARP rejected agreements between the record companies and smaller webcasters because it found that the larger webcasters, which had more bargaining power, were more relevant to establishing a market rate.” (SX FoF, ¶ 212)

(c) “AccuRadio, which is representative of the small commercial webcasters, generates revenue from a similar set of ads . . . .” (SX FoF ¶ 681)

(d) “However, small webcasters have entered the market since the 2002 CARP as well, although many of the ‘small’ webcasters like AccuRadio and RadioIO offer dozens of channels each and reach hundreds of thousands of listeners each month.” SX FoF, ¶ 685)

(e) “Small webcasters are also able to make streaming profitable.” (SX FoF, ¶ 712; citing SBR Creative as a small webcaster.

(f) “Even so-called ‘small’ webcasters, such as AccuRadio and RadioIO, have separate pages optimized for use by mobile devices.” (SX FoF, ¶ 893)

(g) “The Small Commercial Webcasters’ Rate Proposal also is based on the rates that webcasters pay to ASCAP and BMI. For all of the reasons discussed above concerning the illegitimacy of the musical works benchmark, the Rate Proposal is based on an inappropriate benchmark.” (SX FoF, ¶ 1476; *citations omitted*).

These references are addressed below.

3. Its first two points, 2(a) and 2(b) above, are put forward in support of SoundExchange’s theory that any rate that is set must reflect the deal that would be struck between the largest, most successful webcaster, and the record companies acting as a unit. Brynjolfsson Direct at p. 6. This contention ignores Mr. Brynjolfsson’s own testimony that differences in the situation of a Buyer can create a wholly different market, with its own pricing

structure. For instance, in response to a question from the Board, Mr. Brynjolfsson acknowledged that the “market” in which a local retailer operates is different than that in which a big box store operates. Tr. Vol. 7 at pp. 113-114 (Brynjolfsson). That is exactly the distinction present in this case – there is a distinct difference between SCW and the larger webcaster with “spillover” from other lines of business. SoundExchange simply does not address the SCWs’ contention that small, entrepreneurial webcasters focusing exclusively on the provision of audio services to the public are fundamentally different than large webcasters that provide audio services for corporate parents as a small portion of the parent company’s online presence. Hanson Direct at ¶ 1; Tr. Vol. 33 at pp. 18-19 (Hanson). Nor did SoundExchange present any evidence to the Board that SCWs and large webcasters should be treated identically under a statutory royalty scheme based on a “willing buyer/willing seller” standard.

4. While SoundExchange contends that Mr. Brynjolfsson’s testimony does not rely on the “spillover” effects of other businesses in determining who a willing buyer would be (SX FoF, ¶ 636), this is refuted by his testimony. As cited in the SCW FoF, at ¶ 4, his testimony was consistent in stating that an efficient webcaster is one which receives spillover effects. Tr. Vol. 6 at pp. 26-27 (Brynjolfsson). These indirect benefits would be taken into account in setting rates. Tr. Vol. 6 at p. 29 (Brynjolfsson). Webcasters are especially profitable, and earn more when there is spillover. Tr. Vol. 6, pp. 44-45 (Brynjolfsson). Clearly, it must be concluded that, in looking at the most profitable webcaster used in his model, Mr. Brynjolfsson was focusing on a webcaster with spillover revenues, not a pure Internet Radio site like that provided by the SCW.

5. SoundExchange’s implication in 2(a) above, that SCWs do not “attempt[] to maximize their webcasting revenues” and are “not primarily driven by market concerns,” is specious and ignores all of the SCWs’ testimony on point, which demonstrates that the SCWs (a)

are commercial entities seeking to maximize their profit; (b) are therefore driven by the same market concerns that drive any business attempting to offer a single primary service to the market; but (c) those same "market concerns" will drive the SCWs out of business if the statutory royalty rate is set too high. Hanson Direct at ¶ 4. As Mr. Hanson stated, the Small Commercial Webcasters are "small business people trying to build lasting companies." Tr. Vol. 33, p. 19 (Hanson).

6. In points 2(c), 2(d), and 2(f), SoundExchange seems to be implying that SCWs are entering the market and can operate profitably under the current royalty rate, and thus that rate is set too low. SoundExchange wholly ignores the fact that the SCWs as a class are generally not profitable at the present time can continue in business only because they pay royalties under the Small Webcasters Settlement Act, and certainly would not be profitable at the royalty rate proposed by SoundExchange. Hanson Direct at ¶ 2, 4, 35, 36; Tr. Vol. 33, pp. 41-42. For instance, AccuRadio had monthly revenues of approximately \$[REDACTED] per month in 2005, and monthly revenues in the same range in 2006. Hanson Direct at 39; Tr. Vol. 33, p. 38 (Hanson). Positing a statutory royalty rate of \$.01/hour (the current statutory rate absent the Small Commercial Webcaster Settlement Act) on AccuRadio's approximately [REDACTED] monthly listener-hours, AccuRadio's sound recording royalty obligation alone would be approximately \$[REDACTED] per month. Hanson Direct at ¶ 35. For almost all SCWs, even the current non-SCW statutory rate would make it impossible to remain in business.

7. Despite extensive discovery, SoundExchange has offered no evidence to refute the conclusion that the SCWs would be out of business if not for the Small Webcasters Settlement Act, but for its contention in point 2(e) above, claiming that SBR Creative is a small

webcaster making a profit. In fact, SBR Creative is in a wholly different business than the SCW. SBR does not receive its revenue from advertising support, as do the SCWs. Instead, it creates "side-channels," unique Internet streams, for broadcasters, and receives its income from payments from broadcasters for those streams. SX Trial Ex. 118, p. 2 ("How Much Do Side Channels Cost"). It does not get involved in selling advertising. Tr. Vol. 32, p. 20 (Rahn). Essentially, SBR Creative is relying on the "spillover" of the broadcaster's business for its revenues, not on its own ability to obtain advertising revenues as do the SCW entities.

8. SoundExchange's references to the SCWs' financial standing are all advanced as purported support for its own royalty rate theories, in particular the analysis advanced by SoundExchange witness Brynjolfsson. To do so, it cites predictions and projections as fact, and cites facts out of context. SoundExchange references Hanson's testimony in this regard for the purpose of: a prediction that Google's entry into the radio broadcasting market will add new advertisers to the market (SX FoF ¶ 604); a prediction that 2 cents revenue per listener hour would make a webcaster profitable (SX FoF ¶ 627); and a statement that AccuRadio was started for \$50,000 of Hanson's own money and that its capital expenses are minimal (SX FoF ¶ 655, 685, 713).

9. Notably, the entry of Google into the webcasting market has not resulted in any advertiser revenue for AccuRadio Tr. Vol. 33, p. 127 (Hanson). AccuRadio itself has not achieved 2 cents per listener hour in revenues. Hanson Direct at ¶ 38 (showing that royalties at 1 cent per listener hour would exceed the Company's current revenue). AccuRadio is not profitable even while it is paying royalties under the Small Webcaster Settlement Act. SX Trial Ex. 125. The fact that Hanson put his own seed money into AccuRadio and keeps its expenses



as low as possible demonstrates the difficulty of keeping a small webcaster afloat even at current royalty rates.

10. SoundExchange also references the Hanson testimony in connection with its argument that the webcasting market is growing and thus, *ipso facto*, the statutory royalty rate must also change. In this context, SoundExchange cites statements by Hanson or AccuRadio documents relating to: the fact that large portal sites have a competitive advantage (SX FoF ¶ 798); the types of advertising and other revenues webcasters generate (SX FoF ¶ 676, 681); the value of shares of AccuRadio sold to two investors (SX FoF ¶ 713); AccuRadio's revenues in 2003-2005 (SX FoF ¶ 734); and the financial figures in AccuRadio's pro forma and the purpose for which it was prepared (SX FoF ¶ 759, 761, 762, 827, 831). Separately, SoundExchange cites a prediction by Hanson about the rise of wireless technology (SX FoF ¶ 894), and testimony regarding the fact that record companies approach AccuRadio to have their music played, but that AccuRadio also spends money to purchase CDs (SX FoF ¶ 975).

11. Of course, the Hanson testimony regarding the competitive advantage of large webcasters only highlights the fact that the SCWs are in a different business, fighting to survive, by trying to grow an audience while keeping their revenue shortfall as low as possible as the business is in the early stages of its growth. Optimistic predictions about the future of webcasting, and about AccuRadio's potential growth, are all based on the assumptions that revenues and audiences will grow and that a reasonable statutory royalty rate will be adopted. If replaced by the rates proposed by SoundExchange, all of those predictions are moot, as the SCWs will go out of business. Tr. Vol. 33, pp. 125-126 (Hanson). Moreover, SoundExchange's reliance on the fact that AccuRadio was able to obtain investors in the past is belied by the fact that the last investment was made over a year ago, and recent attempts to bring in new investors

necessary for growth have been unsuccessful. Investors are reluctant to invest for a number of reasons, including the fact that the advertising market has not grown as anticipated, that wireless delivery has a low take-up rate, and the fear of new higher royalties. Tr. Vol. 33, p. 125 (Hanson). And, while Mr. Hanson stated that widespread wireless technology would expand the audience size of Internet Radio, he also stated that he was not sure it would happen. Tr. Vol. 33 at pp. 91-92. He did not see wireless as a big factor in 2006-2010. Tr. Vol. 33, p. 127-128 (Hanson). The take-up rate for such services has been very slow. Only 8% of customers use their cell phones for any music service, much less a wireless one allowing listening to Internet Radio. Tr. Vol. 33 at p. 128. These facts not only undermine SoundExchange's reliance on such evidence to support its own theories of the profitability of Internet Radio, but further suggests that the SCWs' proposed rate is appropriate for this class of webcasters.

12. Again, the apparent purpose of these few references to SCW testimony is to bolster SoundExchange's own evidence, none of which directly rebuts the proposal for a separate rate for SCWs themselves. SoundExchange's only direct challenge to a separate rate goes to the specific percentage proposed rather than to the concept of a separate rate. SoundExchange argues that the specific rate proposed by the SCWs should not be based on the musical works royalty, based on its arguments that such a benchmark should not be used for the large webcasters. (SX FoF ¶ 1476). Yet for the Buyer in this case, the SCW, the musical works benchmark is indeed the right most analogous to the one at issue here, as the value to the webcaster is identical. Without both of these royalties, the webcaster cannot broadcast a song on its Internet Radio station. Tr. Vol. 33, p 44-45 (Hanson). In fact, as Mr. Hanson pointed out, in many instances the sound recording license may be less important than the composition, as "cover" channels, featuring different artists singing the same underlying composition, are

popular on Internet Radio. Tr. Vol. 33, p 46. But, as both royalties convey portions of the same benefit, the right to play a recorded song on the Internet, the value should be the same.

13. For all of the reasons set forth in the SCW's proposed Findings of Fact and Conclusions of Law, that percentage-of-revenue model, at the same rate as the composition royalty, is the most appropriate rate for this particular class of webcasters. (SCW FoF, ¶¶ 24-30)

### **Conclusions of Law**

1. As noted in the SCWs' Proposed Findings of Fact and Conclusions of Law, the "willing buyer/willing seller" standard in section 114(f)(2)(B) of the Copyright Act is intended to reflect fair market value, which should lead to a range of negotiated rates in a properly operating market. (SCW FoF ¶¶ 5-6) Section 114 expressly states that "rates and terms shall distinguish among ... different types of eligible nonsubscription transmission services ... , such differences to be based on criteria including, but not limited to, the quantity and nature of the use of sound recordings and the degree to which use of the service may substitute for or may promote the purchase of phonorecords by consumers." 17 U.S.C. § 114(f)(2)(B). These differences "may account for differences in rates and terms between different types of transmissions," H.R. 105-796 at 85, and the Board may set different rates for services that are differently situated so long as the record evidence supports the distinction. *See 2002 Final Rule*, 67 Fed. Reg. at 45254-55.

2. Here, the SCWs have presented evidence that large webcasters and smaller independent webcasters are situated differently, because small commercial webcasters support their webcasting services solely through revenues from their primary business, webcasting. Indeed, a SCW represents a "willing buyer" not impacted by extraneous financial concerns such as other business units offering other types of services, and the "spillover" to and from such other lines of business. To the extent that a royalty rate would drive SCWs out of business or

prevent other Internet Radio-focused businesses from entering the market, then this suggests that the rate has been set at a level that is viable only for webcasters with other sources of income, or those that can sustain a long period of negative earnings until a certain market size has been attained.

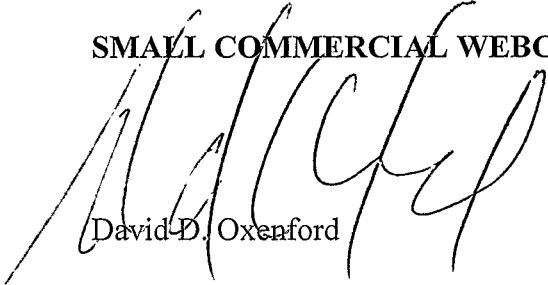
3. SoundExchange's contention seems to be that a market that weeds out all but the strongest competitors is desirable and is what Congress intended. This position ignores the underlying purpose of the statutory royalty – to make it easier for firms to enter the business by removing the high transaction costs of having to negotiate individual royalty arrangements with every copyright holder of every recording that is to be played on the Internet. Effectively, the establishment of a statutory royalty was to encourage diversity on the Internet's "airwaves," by allowing all Internet Radio operators access to all copyrighted music for use on their programs. Yet SoundExchange would turn this inclusory purpose on its head, and adopt an exclusionary royalty rate that would allow only the strongest, richest webcaster to stay in business. SoundExchange would establish a royalty that serves as a barrier to entry, not allowing new competitors into the market, unless those competitors have diverse business models allowing revenues from other lines of business to support their webcast operations. That is, the Board would be shutting the door to all webcasters who intend to enter the market to provide webcasting services as their primary focus. Surely, Congress would not establish a royalty for Internet Radio with the idea that the rate set for such royalty would not allow a pure Internet Radio Company to survive. It did not establish a royalty that would only allow portals to operate in the market.

4. As stated in Section 114, Congress established a royalty which "distinguishes among different types of eligible nonsubscription transmission services." Thus, as the SCWs are

“a different type” of service, a separate royalty for the Small Commercial Webcaster must be established. It would not be “reasonable” within the meaning of Section 114(f)(2) to set rates that exceed the revenues and financial reserves of small businesses that are growing audiences from scratch, simply because there are other businesses with an entirely different financial model offering webcasting as only one aspect of their service. The reasonable royalty must allow this unique class of webcaster to survive. Thus, it must be based on a percentage of revenue, and should be set at a rate comparable to that paid for the underlying musical work. Thus, the SCWs respectfully request that the Board establish a royalty at 5% of the webcasting gross revenue.

Respectfully submitted,

**SMALL COMMERCIAL WEBCASTERS**



David D. Oxenford

*Counsel for AccuRadio, LLC; Digitally Imported, Inc.; Radioio; Discombobulated, LLC; 3wk, LLC and Radio Paradise, Inc.*

Davis Wright Tremaine LLP  
1500 K Street, N.W., Suite 450  
Washington, D.C. 20005  
(202) 508-6600

Dated: December 15, 2006

## CERTIFICATE OF SERVICE

I, Rhea Lytle, hereby certify the following on the 15th day of December 2006 in Docket No. 2005-1 CRB DTRA, I have served the following parties the **REPLY FINDINGS OF FACT AND CONCLUSIONS OF LAW** via electronic mail and overnight express delivery:

Bruce G. Joseph, Esq.  
Karyn K. Ablin, Esq.  
Wiley, Rein & Fielding LLP  
1776 K Street, N.W.  
Washington, D.C. 20006  
(P) 202.719.7258  
(F) 202.719.7049

[bjoseph@wrf.com](mailto:bjoseph@wrf.com), [kablin@wrf.com](mailto:kablin@wrf.com)

*Counsel for Bonneville International Corporation, Clear Channel Communications, Inc., National Religious Broadcasters Music License Committee, National Religious Broadcasters Noncommercial Music License Committee; Salem Communications Corp. and Susquehanna Radio Corp.*

Kenneth L. Steinthal  
Weil Gotshal Manges LLP  
201 Redwood Shores Parkway  
Redwood Shores, CA 94065  
(P) 650.802.3000  
(F) 650.802.3100

[kenneth.steinthal@weil.com](mailto:kenneth.steinthal@weil.com)

*Counsel for America Online, Inc., Digital Media Association, and Yahoo!, Inc.*

William Malone  
James R. Hobson  
Miller & Van Eaton, PLLC  
1155 Connecticut Avenue, N.W., Suite 1000  
Washington, D.C. 20036-4306  
[wmalone@millervaneaton.com](mailto:wmalone@millervaneaton.com)  
(P) 202.785.0600  
(F) 202.785.1234

*Counsel for Intercollegiate Broadcasting System, Inc. and Harvard Radio Broadcasting Co., Inc.*

Kristin K. Brown, Esq.  
Weil Gotshal Manges LLP  
1501 K Street, N.W., Suite 100  
Washington, D.C. 20005  
(P) 202.682.7024  
(F) 202.857.0940

[kristin.brown@weil.com](mailto:kristin.brown@weil.com)

*Representative for National Public Radio, Inc.*

**SCA DIRECT CASE REDACTION LOG**  
**REPLY FINDINGS AND CONCLUSIONS**

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Thomas J. Perrelli, Esq.  
Jenner & Block LLP  
601 13<sup>th</sup> Street, N.W., Suite 1200 South  
Washington, D.C. 20005-3823  
[TPerrelli@jenner.com](mailto:TPerrelli@jenner.com)  
(P) 202.639.6000  
(F) 202.639.6066  
*Counsel for SoundExchange, Inc.*

Kenneth D. Freundlich, Esq.  
Schleimer & Freundlich, LLP  
9100 Wilshire Boulevard, Suite 615 East  
Beverly Hills, CA 90212  
(P) 310.273.9807  
(F) 310.273.9809  
[kfreundlich@earthlink.net](mailto:kfreundlich@earthlink.net)  
*Counsel for Royalty Logic, Inc.*

David W. Rahn  
Co-President  
SBR Creative Media, Inc.  
7464 Arapahoe Road, Suite B4  
Boulder, CO 80303  
[dave@sbrcreative.com](mailto:dave@sbrcreative.com)  
(P) 303.444.7700  
(F) 303.444.3555

Seth D. Greenstein, Esq.  
Constantie Cannon, P.C.  
1627 Eye Street, N.W., 10<sup>th</sup> Floor  
Washington, D.C. 20006  
(P) 202.204.3500  
(F) 202.204.3501  
[sgreenstein@constantinecannon.com](mailto:sgreenstein@constantinecannon.com)  
*Counsel for Collegiate Broadcasters, Inc.*

  
Rhea Lytle





## Davis Wright Tremaine LLP

ANCHORAGE BELLEVUE LOS ANGELES NEW YORK PORTLAND SAN FRANCISCO SEATTLE SHANGHAI WASHINGTON, D.C.

DAVID D. OXENFORD  
DIRECT (202) 508-6656  
davidoxenford@dwt.comSUITE 450  
1500 K STREET NW  
WASHINGTON, D.C. 20005-1272TEL (202) 508-6600  
FAX (202) 508-6699  
www.dwt.com

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December 15, 2006

Copyright Royalty Board

**VIA HAND DELIVERY**Copyright Royalty Board  
Library of Congress  
James Madison Memorial Building  
101 Independence Avenue, S.E.  
Room LM-401  
Washington, D.C. 20559-6000**Re: Public Version of Reply Findings of Fact  
and Conclusions of Law**

Dear Sirs:

Please find enclosed five (5) copies and a receipt copy of the public version of the Reply Findings of Fact and Conclusions of Law of AccuRadio, LLC; Digitally Imported, Inc.; Radioio; Discombobulated, LLC; 3wk, LLC and Radio Paradise, Inc. Please have the receipt copy stamped and return to the courier.

If there are any questions, please contact the undersigned.

Sincerely,

  
David D. Oxenford

Enclosure